

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Cogdill Analyst: Roger Lackey Bill Number: AB 475
Related Bills: See Legislative History Telephone: 845-3627 Introduced Date: 02-21-2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Employer Qualified Wage Credit

SUMMARY

This bill would allow a small business that is located in a qualified area a credit based on employees' wages.

PURPOSE OF THE BILL

The author's staff has indicated that the purpose of this bill is to offset small employer costs due to increases in the minimum wage.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. The credit would apply to taxable years beginning on or after January 1, 2002, and before January 1, 2009.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to assist the author in resolving the implementation and policy considerations discussed below.

ANALYSIS

FEDERAL/STATE LAW

Existing **state and federal laws** allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's business (e.g., including employee wages and benefits).

Existing state law provides various tax credits that are designed to provide tax relief for taxpayers who must incur certain expenses (e.g., renter's credit) or to influence behavior, including business practices and decisions (e.g., research credits). For instance, taxpayers engaged in a trade or business in an economic development area are allowed a hiring credit for a certain percentage of qualified wages paid to qualified employees.

Board Position:	Department Director	Date
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THIS BILL

This bill would allow a qualified employer a credit for the qualified wages paid to employees.

A qualified employer would be any employer that has 100 or fewer employees and is in a qualified area.

“Qualified area” would mean a county with an unemployment rate, as determined by the Employment Development Department (EDD), equal to or greater than 150% of the statewide average unemployment rate.

“Qualified wages” would be that portion of employee wages that represents the difference between the minimum wage as of December 31, 2000 (\$5.75 an hour), and the minimum wage at the time the wages are paid and incurred (currently, \$6.25 an hour).

Any unused credit may be carried forward indefinitely.

IMPLEMENTATION CONSIDERATIONS

This provision appears to conflict with the author's stated purpose of only helping employers to offset increases in the minimum wage. This bill would allow the credit for all wages paid to all employees that are in excess of the minimum wage, not just those who are being paid the minimum wage. That is, highly paid employees would qualify the employer for this credit. If the author intends to restrict the credit to only minimum wage employees, the bill would need to be amended.

The bill limits the credit to amounts equal to qualified wages paid by a qualified employer in a qualified area. It is unclear whether the credit is limited to wages paid to employees for services performed in a qualified area, or to qualified employers with a place of business in a qualified area, or some combination of the above.

This bill does not limit the number of years for the carryover. The department would be required to retain the carryover on the tax forms indefinitely because unlimited credit carryover is allowed. Recent credits have been enacted with a carryover limit since experience shows credits typically are exhausted within eight years of being earned.

LEGISLATIVE HISTORY

SB 2010 (Hurt, 1995/1996) would have allowed a credit equal to an unspecified percentage of qualified minimum wages that were paid or incurred by an employer. This bill failed passage in the Senate Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The laws of Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York were reviewed because their tax laws are similar to California's income tax laws.

Florida income tax law allows an enterprise zone job credit equal to 10% of the actual monthly wages of an employee not to exceed \$1,500 in total wages per employee a month.

Illinois income tax law allows a credit for expenses associated with the federal employment credit that were disallowed as a federal deduction.

Massachusetts income tax law allows a credit for expenses associated with the federal employment credit that were disallowed as a federal deduction. In addition, the state allows a \$100 full employment credit per new employee for employers.

Michigan income tax law allows a qualified new job credit limited to a specified amount of the employer's payroll.

Minnesota income tax laws do not provide for any employee wage related credits.

New York income tax law allows an employment incentive tax credit based on the investment tax credit.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Tax Revenue Estimate

This bill is estimated to impact PIT and B&CT revenues as shown in the following table.

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 2001 Enactment Assumed After June 30, 2001 \$ Millions			
2001-02	2002-03	2003-04	2004-05
-\$60	-\$550	-\$825	-\$975

Note: The revenue above assumes all employed individuals, not just those making minimum wage, would qualify employers for the tax credit.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue impact for this bill will be depend upon the number of qualified employers located in certain high unemployment counties, amount of wage differentials paid, and the amount of available tax liabilities of qualified employers.

This estimate was developed in the following steps. First, according to statistics from the Employment Development Department (EDD), there are approximately 16.5 million individuals employed in the State of California, which 1.8 million are employed in counties that have at least 150% the California unemployment rate as of January 1, 2001 (4.5%).

This number was adjusted downward to reflect those employed by government entities, leaving 1.5 million qualified individuals. Second, according to the same source, the average weekly hours worked is approximately 30 hours, or 1,500 hours annually. Third, according to the Industrial Welfare Commission, the minimum wage as of December 31, 2000 was \$5.75 an hour and will increase to \$6.75 an hour as of January 1, 2002, a \$1.00 per hour increase. Multiplying these three elements, the total generated credit amount for tax year 2002 is projected to be approximately \$2.35 billion. This number was further adjusted downward to reflect eligible businesses (i.e. less than 100 employees), leaving \$2.3 billion in generated credits for tax year 2002. It was assumed that on average, 25% of generated credits would be applied against available tax liabilities in the first tax year. The low usage rate was used because of the high credit amount generated by employers. The 2002-03 first full fiscal year estimate includes this impact plus part of the 2003 impact to allow for reduced estimated tax payments.

ARGUMENTS/POLICY CONCERNS

This bill would have the effect of providing a double benefit for deductible wages by virtue of this credit and the ordinary deduction of these wages from the income of the trade or business.

This bill would allow taxpayers located within enterprise zones and targeted tax areas, to claim both this credit and the hiring credit based on the same wages. The existing hiring credit provisions do not restrict the taxpayer to one credit based upon a single employee.

This bill does not limit the credit to wages paid to employees that are employed within this state.

This bill would allow employers to claim a credit for employees who are relatives of the taxpayer, and would allow self-employed taxpayers to claim the credit on their own wages.

LEGISLATIVE STAFF CONTACT

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